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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Decided on: 22.02.2018

+ **ITA 507/2014**

THE COMMISSIONER OF INCOME TAX-IV Appellant

versus

DLF COMMERCIAL DEVELOPERS LTD. Respondent

+ **ITA 563/2015**

PR. COMMISSIONER OF INCOME TAX-3 Appellant

versus

DLF COMMERCIAL DEVELOPERS LTD. Respondent

+ **ITA 610/2017, C.M. APPL.28227/2017**

PR. COMMISSIONER OF INCOME TAX-IV Appellant

versus

DLF COMMERCIAL DEVELOPERS LTD Respondent

Through : Sh. Amol Sinha and Sh. P. Roychaudhuri, Advocates, for respondent, in Item Nos.11 to 13.

Sh. Ashok. K. Manchanda and Sh. Raghavendra Singh, Advocates, for Revenue, in Item Nos.11 and 12.

Sh. Deepak Anand, Jr. Standing Counsel, Revenue, in Item No.13.

Sh. Balbir Singh, Sr. Advocate with Sh. P. Roychaudhuri and Sh. Anil Kumar, Advocates, for respondent, in Item Nos.11 to 13.

CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT

HON'BLE MR. JUSTICE A.K. CHAWLA

MR. JUSTICE S. RAVINDRA BHAT (OPEN COURT)

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1. The following questions of law arise for consideration:

In ITA 507/2014

“(i) Did the Income Tax Appellate Tribunal (ITAT) fall into error in holding that the application of Section 263 by the CIT(A) in the circumstances of the case was not warranted?”

“(ii) Did the ITAT fall into error in holding, on the merits, that sale of assets and buildings to the co-developer could have been treated as capital gain and not business income?”

2. The brief facts are that the assessee/respondent sought to take advantage of provisions of Section 80IAB of the Income Tax Act, 1961 [hereafter “the 1961 Act”] for the development of a Special Economic Zone (SEZ) on the basis of land acquired/allotted to it. It claimed deduction to the tune of ₹5,84,93,80,397/- under the said provision, being profits from the Hyderabad SEZ Project.

3. The Assessing Officer (AO), after considering the material on record, permitted deduction to the tune of ₹5,73,94,33,765/-. The income reported was from the sale of the bare shell building over which a long term lease of 49 years’ tenure was given to the co-developer. The co-developer – M/s DLF Assets Private Limited, was the transferee of these assets. After completion of assessment, the CIT(A), exercising his powers under Section 263 of the 1961 Act, issued notice on 05.05.2011 asking the assessee to show cause why the assessment ought not to be interfered with on the ground that the AO committed an error of law and that the order was prejudicial to the interest of the Revenue and that the assessee had sold bare shell building, which was not a permissible activity and the benefit of Section 80IAB could not be granted towards such sale/transfer.

4. The assessee resisted the notice contending that the induction of co-developer under the Special Economic Zones Act, 2005 [hereafter “SEZ Act”] was permissible by reason of Section 3(11). According to the assessee, the understanding arrived at with the co-developer was in fact notified to the Government of India, which granted approval on 01.05.2007. The agreement was for co-development of the entire SEZ and these facts were not withheld but fully disclosed to the relevant authority under the SEZ Act, i.e. the Board of Approval. The CIT(A) rejected the assessee’s contentions and held as follows:

“6. As enumerated above the assessee company is a developer of SEZ, during the year claimed deduction u/s 80IAB on the development income receipt from the co-developer which is also a company of same group. Deduction u/s 80IAB amounting Rs. 573,94,33,765/- was allowed by the AO on the basis of accounting method followed by the assessee, relevant provisions of SEZ Act including provision of Income Tax "Act and after examining taxability of the "development income" claimed exempt by the assessee company.

Section 80IAB of the IT Act inserted by SEZ Act gives assessee deduction of 100% of profit and gains derived from the business of developing SEZ. This deduction is available for 10 consecutive assessment years and this deduction is also allowable to the co-developer on transfer collaboration and maintenance of SEZ for remaining period in 10 consecutive assessment years. Thus section 80IAB clearly refers to exemption for profit from operation and maintenance of SEZ only and not for profit from sale of assets. This section does not specifically provide for a deduction to income arising from the transfer of assets to a co-developer by a developer.

7. (i) The detailed examination of issues involved as above in the assessee's case, establish the followings:

a. Rule 11(10) of SEZ Rules 2006 specifies that the developer shall not sell the land in a SEZ. As sale of land is prohibited and it was possible for the assessee to sell the buildings only, the land has been given to co-developer through an arrangement of lease of land which is nothing but a play to overcome this prohibition.

b. Sale of buildings to the co-developer is not an activity of development of SEZ. It is an isolated transaction giving one time income from transfer of capital assets. It is very clear from the agreement that the intention from the very beginning was to construct and sale the buildings as a onetime activity. Such isolated transaction can never be termed as business activity. Co-developer agreement is very clearly showing that the developer loses all rights over these assets and the relinquishment of right is irrevocable.

c. There is no dispute that buildings have been sold to Co-developer.

d. Though SEZ Act prohibits for sale of land thereby implicitly denying any benefit to a developer who is basically interested in deriving income by transfer of assets, the assessee has found a way to overcome this prohibition by creating 49 years lease in favour of co-developer, renewable further, thus effectively transferring the land also.

e. SEZ Act notifies specific authorized operations which alone would qualify for exemptions, concessions and drawbacks. Therefore income from sale or transfer or such operation would not be eligible for exemption as per notification no. S.O. 1846(E) dated 27th October, 2006.

(ii) In view of the above, the assessee's income from the sale of assets is not eligible for deduction U/S 801AB.

(iii) Once it is established that the transfer of buildings to co-developer is not a business activity and the income from such

transfer is not business income, it is clear that sale of such buildings, in the nature of capital assets, has generated capital gains and, therefore, income shown by the assessee on this count has to be treated as capital gains.

On examination of the assessment records for the A.Y. 2008-09, it is seen that the A.O has allowed the deduction u/s 80IAB wrongly without considering the above facts so as to render the assessment order not only erroneous but also prejudicial to the interest of revenue. Hence, the assessment is set aside on this limited issue to be reframed by the AO after considering the above facts and after giving the assessee opportunity of being heard.”

5. The assessee appealed to the ITAT which by the impugned order took note of the letters written by the Board of Approval and the Central Government to clarify queries made by the assessee with respect to the permissibility of the transaction of sale of bare shell building and was of the opinion that in the facts of this case, the AO had conducted sufficient enquiry and invocation of provisions of Section 263 was, therefore, unwarranted.

6. This Court has considered the submissions of the parties. The question as to whether sale of bare shell building is *per se* a deductible activity falling within Section 80IAB has, in the opinion of the Court, not been adequately considered or addressed. The Central Government's clarifications were issued to the assessee, at its request. The AO must have analysed the provisions of the Act, especially, the notifications governing the setting-up of the SEZs and the permissible activities in such zones with their investors (Section 80IAB) and the circumstances of the case, i.e. the agreement entered into with the co-developer, the conditions of lease etc., had to be

analysed in detail. Clearly, the AO did not conduct that detailed enquiry. On the other hand, the AO's order merely indicates that the analysis, if at all, it could be characterized as such of the assessee's claimed SEZ activity was in the context of allegations of varied expenses, as is apparent from the AO's order dated 29.12.2010 below, which was clearly inadequate:

"11. Allocation of Overheads not apportioned to SEZ Project:

The assessee during the assessment has claimed deduction of Rs.584,93,80,397/- U/s 80IAS in respect of profit from Hyderabad SEZ Project. In order to work out the correct profit from the Hyderabad SEZ project for calculation of deduction U/s 80IAS the assessee company vide questionnaire dated 6.12.2010 was asked the following question:

"In your letter dated 22.10.2010 at Point No.3 you have mentioned that Administrative Expenses of Rs.206.59 lacs have been allocated to Hyderabad SEZ project while computing deduction U/s 80IAS. However, it has been observed that the total cost of Hyderabad SEZ Project have been shown in Schedule-XVI of the Profit and Loss Account. As per the profit and loss account the following expenses have been debited which are not allocated while computing profits of the Hyderabad SEZ project;

- a. Establishment charges RS.2712.36 lacs*
- b. Finance charges RS.8575.81 lacs*
- c. Other expenses Rs.4242.01 lacs*
- d. Depreciation Rs.753.80 lacs*

You are required to show cause that why the above mentioned expenses should not be allocated while computing the profit from the Hyderabad SEZ Project."

7. Furthermore, in the absence of a detailed analysis of the factual narration with respect to the transactions and the documents, having regard

to the provisions of the SEZ Act and the purpose for which SEZs are set-up, to ensure that such areas develop in a sustained and consistent manner, with assured infrastructure support on a continuous basis by developers, the CIT(A)'s opinion that the assessment order was erroneous in law and prejudicial to the interest of the Revenue was justified. As a result, it is held that the ITAT erred in interfering with the order of the CIT(A). Consequently, the impugned order needs to be set aside. The order of the CIT(A) under Section 263 is, therefore, upheld. The CIT(A)'s observations, however, shall not be construed as conclusive or as binding; the discussion with respect to the permissibility of the deduction claimed shall only be considered in the light of the noting to reopen the assessment. Resultantly, the AO is directed to complete the assessment having regard to the rights and contentions of the parties in accordance with law, expeditiously and preferably, within six months.

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8. The following question of law arises for consideration:

“Did the ITAT fall into error in holding, on merits, that sale of assets and buildings to the co-developer could have been treated as capital gain and not business income?”

9. In the present appeals, the ITAT has merely followed the decision rendered in a previous order. The earlier decision in this regard is the one rendered in 2007-08 in the case of DLF Infocity Developers (Chennai) Ltd. There, the Assessing Officer's (AO) order granting deduction under Section 80 IAB was interfered with by the CIT(A) under Section 263 of the Income Tax Act, 1961 [hereafter “the 1961 Act”]. The ITAT proceeded to set-aside the order, holding on merits that the assessee was entitled to the deduction

claimed. That order has been followed on merits by the ITAT in the current A.Y. 2009-10 and 2010-11.

10. This Court is of the opinion that the ITAT's decision merely reproduced the CIT(A)'s judgment and has not analysed independently, in either of the AYs, the applicability of Section 80IAB towards the deductions claimed in the light of the transactions reported and the documents disclosed. Furthermore, those facts have also to be analysed in the light of the provisions of SEZ Act, 2005, which the ITAT has not independently done. For these reasons, the impugned orders of the ITAT are set-aside and are remitted for fresh consideration by the ITAT in accordance with law. All rights and contentions of the parties are reserved.

11. The appeals are accordingly allowed.

S. RAVINDRA BHAT
(JUDGE)

A.K. CHAWLA
(JUDGE)

FEBRUARY 22, 2018